

STATE OF MICHIGAN
IN THE SUPREME COURT

INNOVATION VENTURES, LLC f/d/b/a
LIVING ESSENTIALS, a Michigan Limited
Liability Company,

Plaintiff-Appellant,

v

LIQUID MANUFACTURING, LLC, a
Michigan Limited Liability Company,
K & L DEVELOPMENT OF MICHIGAN,
LLC, a Michigan Limited Liability Company,
LXR BIOTECH, LLC, a Michigan Limited
Liability Company, ETERNAL ENERGY,
LLC, a Michigan Limited Liability Company,
ANDREW KRAUSE, an individual, and
PETER PAISLEY, an individual,

Defendants-Appellees.

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Court of Appeals No. 315519

Oakland County Circuit Court
Case No. 12-124554-CZ

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**APPELLANT INNOVATION VENTURES, LLC'S REPLY BRIEF IN
SUPPORT OF ITS APPLICATION FOR LEAVE TO APPEAL**

ORAL ARGUMENT REQUESTED

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INTRODUCTION

The Court of Appeals rejected ordinary principles of Michigan jurisprudence (do not second-guess contractual consideration; do not conflate employer-employee and commercial non-competes) to disallow common business arrangements between a company and its consultants and contract manufacturers. Defendants do not contest that these issues are jurisprudentially significant, or that subverting these principles will undermine the freedom to contract. Indeed, the Michigan Chamber of Commerce's *amicus* brief shows that the issues raised in Innovation Ventures' application are of critical importance to the broader business community. Instead, Defendants simply say that the Court of Appeals got it right when it adopted foreign case law to void contracts based on post-execution duration and determined that a commercial non-compete *promoting* competition failed under the test for evaluating the reasonableness of employer-employee non-competes. But both of these holdings create a significant rift in Michigan jurisprudence. The Court should grant leave to appeal and reverse.

REBUTTAL FACTS

Defendants' Answer relies on various disputed facts, purported facts not contained in the record, and inadmissible evidence. The following merit response:

1. Defendants improperly quote a *Forbes* magazine article to suggest Innovation Ventures has engaged in abusive and anticompetitive conduct. (Defs' Ans 9.) Media articles are hearsay and not admissible. See *Baker v Gen Motors Corp*, 420 Mich 463, 511; 363 NW2d 602 (1985); *People v McKinney*, 258 Mich App 157, 161 n 4; 670 NW2d 254 (2003) (courts cannot take judicial notice of newspaper articles because they constitute inadmissible hearsay). Moreover, the magazine article is false. There is no "cemetery" and no tombstones commemorating defunct companies. A modicum of research demonstrates this. (See Ex A, ABC News,

5-hour Energy Empire Under Scrutiny Video (Sept 11, 2012), available at <http://goo.gl/5x4dMz> (last visited Mar 31, 2015).) The contemporaneous video shows three cartoon “tombstones” are in front of products made by the Coca-Cola Company, Pepsico, and Nitro2Go, all still in business. There are no “tombstones” in front of the dozens of other energy-shot products. Defendant Krause knows this because he worked a few yards away from the shelf, and regularly had meetings in the room where the shelf was located.

2. The contention that Krause never had access to Innovation Ventures’ trade secrets (see Defs’ Ans 19; COA Op 13; Krause Aff ¶ 2), is vigorously disputed and contradicted by various affidavits submitted by Innovation Ventures. (1/27/2012 Dolmage Aff ¶¶ 4-6, 11; Henderson Aff ¶¶ 9-12, 19.)

REPLY ARGUMENT

I. The Court of Appeals’ failure-of-consideration analysis allows courts to refuse to enforce contracts based on the vicissitudes of judicial views of fairness.

The Court of Appeals’ decision adopts a new minimum consideration requirement for contracts between sophisticated commercial entities. Even though the decision is unpublished, its effect will be broad because it is the only Michigan appellate decision addressing post-execution consideration necessary for changes to an existing business relationship. And the holding is incompatible with this Court’s decisions prohibiting judicial review of the adequacy of consideration and protecting the freedom to contract.

A. Innovation Ventures did not waive its argument.

Innovation Ventures cannot waive an issue first raised in the Court of Appeals’ opinion. Neither Defendants nor the circuit court raised failure of consideration to justify non-enforcement of the Equipment Manufacturing and Installation Agreement. In the circuit court’s

view, the parties never formed a contract. (See 3/14/2013 Op 26 (discussing requirement that there be valid consideration to form a contract).) Innovation Ventures challenged this analysis, reciting the consideration identified in the parties' contracts. (Pl's COA Br 45.) The Court of Appeals agreed with Innovation Ventures and rejected the circuit court's reasoning. (COA Op 10.) Instead, the Court of Appeals believed that both contracts (not just the Non-Disclosure Agreement) were unenforceable because of failure of consideration (*id.* at 10-12), an entirely separate analysis.

Similarly, Defendants did not make an argument based on failure of consideration; they defended the circuit court's reasoning:

In addition, as the trial court found, plaintiff gave no consideration for the [Non-Disclosure Agreement]. The facts surrounding the execution and subsequent termination of the [Non-Disclosure Agreement] do not support a determination that it was offered for a just and honest purpose, or for the protection of a legitimate interest of the plaintiff. Many courts have held that a covenant not to compete must be supported by specific consideration. [Defs' Resp 31.]

(Contra Def's Ans 12 n 3 (selectively quoting *id.*).) Defendants cited two non-Michigan cases requiring additional consideration to impose a non-compete provision in an existing employment relationship. (*Id.* (citing *Bike v Auburn & Assoc Inc Pension Trust*, 588 A2d 538, 542 (Pa, 1991) (adding a non-compete to a pre-existing employment contract requires "a corresponding benefit for the change in status"); *Labriola v Pollard Grp, Inc*, 100 P3d 791, 794 (Wash, 2004) (requiring independent consideration)).) Defendants never advanced an argument based on failure of consideration. If any party waived the failure-of-consideration argument, it was Defendants because they failed to plead it as an affirmative defense as MCR 2.111(F)(3)(a) requires. (Krause & K & L's Ans to 2d Am Compl 18-19.) Innovation Ventures has not waived this issue.

B. The Court of Appeals misapplied the failure-of-consideration doctrine to assess the adequacy of consideration in a situation where the contract operated precisely as the parties anticipated.

The Court of Appeals applied the failure-of-consideration doctrine to refuse to enforce a contract. But the court's analysis is little more than a judicial determination that prolonging a business relationship by two weeks is inadequate consideration for an agreement that contains non-competition and confidentiality provisions. There is no basis in Michigan law for courts to consider the adequacy of consideration in any contract. And the Legislature has specifically said that when parties modify an existing agreement, as even Defendants concede occurred here (Defs' Ans 14-15 n 5), no additional consideration is necessary. MCL 566.1. As *amicus* the Michigan Chamber of Commerce explains, the Court of Appeals' decision "cannot be reconciled with basic contract law principles." (Mich Chamber *Amicus* Br 6.)

The Court of Appeals' ruling has an even broader application than the non-compete provisions that Krause and his company want to disregard in the EMI and Non-Disclosure Agreement. That is because the Court of Appeals invalidated both agreements in their *entirety*, not just the obligations to protect Innovation Ventures from unfair competition. (COA Op 7-8. 10-12.) The Court of Appeals' ruling is much broader than the rule adopted in other states and threatens to undermine arbitration provisions, choice-of-law clauses, and any other contract provision imposed after the parties' business relationship began.

Even if the Court of Appeals' analysis could be limited to non-compete obligations imposed after the outset of parties' business relationships, it still has a deleterious effect on businesses throughout the State. Defendants do not contest that the Court of Appeals' *laissez faire* approach to protecting proprietary information will have a pernicious effect on business investment in Michigan. Nor do Defendants explain how businesses should now augur the

vagaries of judicial temperament to predict how long a business relationship must continue to be “substantial” enough to enforce a run-of-the-mill contract.

Defendants say the Court of Appeals did not weigh adequacy of consideration. But the court expressly held “the discontinuation of the business/employment relationship within two weeks of the signing of the agreements constituted a *failure of consideration*,” and cited cases to that same effect. (COA Op 10-11.) And an inquiry into whether a non-compete is supported by a continuing relationship that lasted a “substantial period” is a departure from courts’ traditional refusal to inquire into the adequacy of consideration. *Curtis 1000, Inc v Suess*, 24 F3d 941, 946 (CA 7, 1994) (Posner, J); see *Summits 7, Inc v Kelly*, 886 A2d 365, 370-371 (Vt, 2005) (rejecting theory adopted by Court of Appeals and identifying assessment of substantial period as inquiry into the adequacy of consideration).

Defendants admit that what the Court of Appeals was really doing was imputing bad faith. (Defs’ Ans 15.) But the record is devoid of evidence regarding *why* the parties ended their relationship when they did. Defendants thus highlight the Court of Appeals’ unsupported speculation as to Innovation Ventures’ motives, which is contrary to the summary-disposition standard that facts be construed in a light most favorable to the non-moving party.¹ *Dressel v Ameribank*, 468 Mich 557, 561; 664 NW2d 151 (2003).

Further, it is *never* bad faith for a party to exercise its rights under a contract. See *Eastway & Blevins Agency v Citizens Ins Co of Am*, 206 Mich App 299, 302-303; 520 NW2d

¹ Similarly, there is no evidence to support the trial court’s conclusion that “[c]oming as it did when [Innovation Ventures] knew that it would be terminating its relationship with K & L, the covenant not to compete is inherently unreasonable.” (3/14/2013 Op 27.) The circuit court expressly stated that if the Non-Disclosure Agreement had “been extracted from K & L at the beginning of the relationship . . . it might have been reasonable.” (*Id.* at 27-28.) Thus, contrary to Defendants’ insinuations, the court did not conclude that the non-compete provision was overbroad. (Contra Defs’ Ans 16-19.)

640 (1994). What the record does show is that the parties contemplated that the EMI could be terminated with 14-days' notice. There is no record evidence that Innovation Ventures ended the relationship in less than 14 days (indeed, the Court of Appeals assumed without record evidence that the business relationship continued for two weeks (COA Op 11)). (Contra Defs' Ans 15.) In fact, the only record evidence regarding when Innovation Ventures' relationship with K & L Development and Krause ended is that it occurred in May 2009. (Krause Aff ¶ 5.) K & L Development and Krause voluntarily accepted the terms of the Equipment Manufacturing and Installation Agreement and the Non-Disclosure Agreement with full knowledge that Innovation Ventures could end the business relationship after two weeks. Even by the Court of Appeals' count, Krause and his company received exactly the consideration they bargained for. As the Michigan Chamber of Commerce summarizes, "[f]ailure of consideration cannot be used to rescind a contract because a court believes it would be unfair to enforce an agreement due to a later event that the parties knew about and addressed when reaching their agreement." (Mich Chamber *Amicus* Br 12.)

The Court should grant leave to reverse the Court of Appeals' decision to remove the uncertainty regarding the enforceability of Michigan contracts.

C. The lower courts have not determined that the exclusivity provision contained in Krause's EMI is unreasonable.

Krause agreed that the EMI memorializes the parties' oral agreement. (Pl's Appl'n, Ex B, EMI 1; Defs' Ans 4, 14 n 5.) Among the obligations that Krause personally undertook was that, during the term of the agreement and for five years after the agreement ended, he would design, manufacture, and produce production equipment for bottling one- to four-ounce bottles of liquid energy shots exclusively for Innovation Ventures. (Pl's Appl'n, Ex B, EMI ¶ 10.) This obligation is relevant because Innovation Ventures alleged that Krause violated the exclusivity

provision. (Am Compl ¶ 96.c.; contra Defs' Ans 20.) None of the lower courts have questioned the reasonableness of Krause's exclusivity agreement. Indeed, Defendants implicitly concede that an agreement "restrain[ing] Krause from designing, building and maintaining bottling equipment" is consistent with "plaintiff's legitimate interests." (Defs' Ans 19.) Accordingly, even if the Court declines to reverse the lower courts' analysis of the reasonableness of the non-competition provision in the Non-Disclosure Agreement, this case should be remanded for further proceedings on Innovation Ventures' claim that Krause breached the EMI.

II. The Court of Appeals ignored the rule of reason by erroneously extending the analysis applicable to employer-employee non-competes to a commercial context.

This case also raises the important question of whether the Legislature intended MCL 445.744a to supplant the common-law rule of reason for all non-compete agreements. The statute specifically addresses agreements or covenants "[a]n employer may obtain from an employee." MCL 445.744a(1). The principal difference between the rule of reason and MCL 445.744a is that former requires consideration of the totality of the circumstances without special solicitude to the effect of the agreement on the restrained party. But the Court of Appeals in this case has applied the heightened protections provided to *employees* (to ensure that they are not prevented from protecting their livelihoods) to *commercial* contracts with non-competition clauses, like Innovation Ventures' contract-manufacturing agreement with Liquid. There is no statutory basis for that extension, particularly in a context like the one here, where the Amended Manufacturing Agreement indisputably *promotes* competition by allowing Liquid to use Innovation Ventures' proprietary bottling equipment and technology to manufacture some, but not all, competing products. The Court of Appeals' analysis of the Amended Manufacturing

Agreement makes no reference to the context in which the parties agreed to a non-competition provision, and does not mention the rule of reason.

Defendants do not contest the applicability of the rule of reason or its requirement that the Court of Appeals consider the totality of the circumstances when considering whether the Amended Manufacturing Agreement ran afoul the Michigan Antitrust Reform Act. (Defs Ans 16.) Defendants do not contest that under the rule of reason applicable to general restraints on trade, the Court of Appeals was required to consider whether the Amended Manufacturing Agreement had any actual anticompetitive effects. Defendants cannot contest that Innovation Ventures was free to prevent Liquid from using Innovation Ventures' manufacturing equipment for any purpose, including preventing Liquid from producing *any* competitors' products. And Defendants do not contest that the effect of the Amended Manufacturing Agreement was increased competition. Nonetheless, the Court of Appeals concluded that the Amended Manufacturing Agreement was an unreasonable restraint on trade because it allowed Plaintiff the discretion to prevent Liquid from producing particular competitors' products. Michigan law should not require companies to choose between unfettered competition and no competition—the result will invariably reduce competition.

The result of the Court of Appeals' analysis is contrary to the common-sense principle that the owner of a particular piece of personal property is free to set conditions on its use. Consider the following hypothetical: A lends his car to B, on the condition that B drive it only from Escanaba to Detroit and back; therefore, B concludes that B is free to drive the car to Montana and back simply because A decided to lend his car to B when he didn't have to. No court would apply B's reasoning to void the limitations A put on the use of his car. The Court of Appeals reached a different result because it focused on *how* Innovation Ventures chose to limit

the use of its manufacturing equipment, rather than viewing the entire context of the parties' transaction to see that the Liquid agreement promoted competition.

The lower courts and Defendants selectively quote from Innovation Ventures' interrogatory responses to suggest that the non-competition provision in the Amended Manufacturing Agreement is solely intended to restrain competition. (Defs' Ans 11; COA Op 7.) But they ignore prefatory language explaining that the parties intended "to protect Plaintiff's goodwill and to prevent Liquid Manufacturing from trading on its prior relationship with Plaintiff, including confidential information it had learned from Plaintiff. Plaintiff was interested in providing Liquid Manufacturing with the ability to bottle energy drinks on a limited basis consistent with Plaintiff's interest in protecting its goodwill and confidential information." (Liquid's Ans, Ex 3, Plf's Fourth Supp Resp to Interrog 31.) The omitted language provides the context necessary to evaluate the Amended Manufacturing Agreement *at the time it was entered into*, and demonstrates that the harm Innovation Ventures was seeking to avoid was something other than increased competition.

The Court should grant leave to clarify that non-competition agreements contained in contracts between contract manufacturers and producers are analyzed under the rule of reason, not the more rigorous requirements of MCL 445.744a.

III. It is unworkable to require a plaintiff to identify specific trade secrets that were misappropriated before discovery is complete.

Defendants do not contest that discovery is necessary before a plaintiff can identify misappropriated trade secrets. Nor do Defendants disagree that full discovery is crucial in these cases, because such activity is typically concealed. And Defendants cannot contest that this case was decided under MCR 2.116(C)(10), without any meaningful document discovery or any depositions. Instead, Defendants argue that the Court of Appeals correctly concluded that

additional discovery was unnecessary because the trial court concluded that the information about the bottling process for 5-hour Energy was not a trade secret. In making that argument, Defendants do not address, or ignore entirely, the following facts:

- The circuit court granted summary disposition on Innovation Ventures' trade secret claims even though Defendants' operative motions did not seek summary disposition on that basis and without affording Innovation Ventures the opportunity to identify genuine issues of fact—Defendants' surprise that Innovation Ventures did not identify the need for additional discovery is feigned (see Defs' Ans 24-25);
- The record before the circuit court showed that Innovation Ventures alleged in the Amended Complaint that Defendants misappropriated trade secrets including the formula for 5-hour Energy, the methods, techniques, and processes for manufacturing 5-hour Energy, and Innovation Ventures' customer and distributor lists (Am Compl ¶ 102);
- The record also contained affidavits identifying specific trade secrets misappropriated by Krause, Paisley, and Liquid (Dolmage Aff ¶¶ 11, 20; Henderson Aff ¶¶ 8-12)—the manufacturing process was not the only trade secret that was misappropriated; and
- The record, when viewed as required in the light most favorable to Innovation Ventures, requires the conclusion that use of Innovation Ventures' trade secrets gave Krause, Paisley, and their companies the ability to go from selling their competing product to miscellaneous tattoo parlors to a \$40 million contract with Wal-Mart in a matter of months (Krause Aff ¶ 13.)

The lower courts' dismissal of Innovation Ventures' misappropriation of trade secrets claims is conclusory and imposes an impossible burden—with no discovery, identify the specific trade secrets actually misappropriated by contractors who learned all the details of a plaintiff's business and then started a competing business. That process is not consistent with the proper administration of justice. The Court should grant leave on this additional issue or, in the alternative, peremptorily reverse and remand this case for discovery in the circuit court.

CONCLUSION AND REQUESTED RELIEF

The Court should grant leave to appeal and reverse.

Respectfully submitted,

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Dated: March 31, 2015

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